International Banking: The Influence of GATS and International Prudential Regulation

Cillian Ryan and Victor Murinde

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1 Introduction

Besides reacting to economic shocks such as the Asian and Latin-American financial crisis and the collapse of the European Eastern Bloc, the world of international banking has had to adapt to a major regulatory shock in recent years and is about to experience another. In the mid to late 1990's The World Trade Organisation attempted to liberalise trade in banking services while more recently the Bank for International Settlements has brought forward new proposals on reserve requirements which are likely to have a differential impact on provision depending on the size and type of bank. In this paper, we evaluate the impact of GATS on international banking activity, particularly in Europe and Asia in the context of the recent international financial 'events' and consider the likely impact of Basel II on the financial service provision and location decisions of international banks as they relate to emerging financial markets.

In section 2 we take, as a starting point, the proposals brought forward by the World Trade Organisation in 1995 for the liberalisation of financial services trade as part of the General Agreement on Trade in Services (GATS). Over the next four years, as the signatories revealed their commitments under the agreement, it appeared that the implementation of the banking provisions would prove problematic, largely because the implications of the liberalisation were poorly understood

by many, especially developing countries, and because of the fear that the proposals would simply allow existing market leaders to usurp national providers. Indeed, in many cases, developing countries, although ostensibly signing up for the GATS, in fact availed themselves of its unique provisions to insert restrictions which meant that for them the agreement amounted essentially to no more than the status quo. Thus many commentators (for example, MURINDE, and RYAN, 2002, p. 98) envisaged very slow market penetration as a consequence of the proposals. The financial crisis of the late 1990's changed all this. As we show below, although international lending to Asia fell in the wake of the financial crisis, lending and deposit-taking by international-bank subsidiaries located or newly established in the problem economies grew. A similar pattern emerged in Eastern Europe.

International Banking now faces another major new initiative, Basel II, which proposes a revision of the Basel Agreement on required capital-asset ratios. In section 3 we consider the likely impact of this new agreement on international trade in Banking and the likely financial service provision and location decisions of international firms operating in emerging financial markets. Section 4 concludes.

2 The GATS and Recent Developments in Banking in Asia and Europe

Following the growth in international trade in goods, as a result of the reduction in tariffs and quotas negotiated through the General Agreement on Tariffs and Trade (GATT), a number of countries attempted to develop a similar agreement on free trade in services in the Uruguay Round. The objective of the General Agreement in Trade in Services (GATS) was to remove the barriers which restricted the ability of service providers and customers located in different countries to enter into international contracts for services, and to remove restrictions on the ability of foreign service-providers to locate freely in other countries. The GATS followed the general principles behind past international trade agreements. It envisaged that:

1. Trade restrictions should be made open and transparent, and thence, through a series of negotiated rounds, member countries should make binding commitments to progressively liberalise markets.
2. When making concessions, a country should treat all foreign countries symmetrically, and therefore a privilege offered to one should be extended to all.[1] The so-called Most Favoured Nation or MFN-clause.
3. Governments should treat foreign and domestic firms operating in a national market symmetrically, the so-called National Treatment clause.

The aim in liberalising financial services was to encourage more competition in a sector frequently regarded as uncompetitive. As a consequence, it was argued,

[1] There is an exemption for common market areas.